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File

EVALUATION OF GUNNAR MINING LIMITED PROPOSAL TO PURCHASE McNAMARA CORPORATION LIMITED

Summary of Study

The study shows why we believe that the acquisition of McNamara Corporation Limited by Gunnar Mining Limited is a sound diversification and why we recommend that the Gunnar Mining shareholders support their management. Briefly, the reasons are as follows:

(1) The terms of acquisition are favourable to Gunnar. It is calculated that Gunnar is buying McNamara at 11 times average last five years' earnings and at 4.7 times average last five years' cash flow. These ratios compare most favourably with those of other companies operating in similar or related fields.

(2) McNamara will add to Gunnar's earning power, particularly for future years when revenues from uranium sales will come to an end.

(3) Gunnar is purchasing one of the fastest growing companies and a leader in one of the most important industries in Canada. Generally speaking, one does well in following the fortunes of a prominent company in any field.

(4) There are many precedents whereby a company is engaged in both mining and construction, for example, Utah Mining & Construction.

(5) The similarity in the nature of the operations of the two companies will facilitate a smooth integration. The long relationship which has existed between the managements of the two companies is also an important factor.

(6) McNamara will further strengthen the capable management team of Gunnar.

(7) The search for new mines will continue with even more vigor. Gunnar is spending and will continue to spend about $800, 000 annually on mining and oil exploration. The large cash reserves are more than adequate to provide sufficient funds to develop new mines or to diversify in other fields.

Toronto, Ontario,
December 21, 1962.

Information contained herein is not guaranteed, but has been obtained from sources we believe to be reliable and informed.

Evaluation of Gunnar Mining Limited
Proposal to Purchase McNamara Corporation Limited

In order to evaluate properly the proposal of Gunnar Mining Limited to acquire McNamara Corporation Limited, it is useful to review the present position of Gunnar Mining Limited.

Gunnar has had a long and successful history. The Company was incorporated by Gilbert A. LaBine in 1933 to develop a gold property in Manitoba and for years it was a successful gold producer. The mine closed twelve years later when all known commercial ore was exhausted.

In 1952 Gilbert A. LaBine acquired for Gunnar a group of uranium claims in the Beaverlodge area of Saskatchewan. In 1954 the Company raised $19,500,000 through a debenture issue and in 1955 became Canada's first post-war uranium producer. Since that time, and up to December 31, 1962, total concentrate sales will have been about $125,640,000. All funded indebtedness was repaid in full by 1960. Contracts to be filled from December 1962 to the spring of 1965 amount to 4,723,000 lbs. or $27,700,000.

Due to substantial earnings, high depreciation and depletion allowances, and despite generous dividend payments, large amounts of funds accumulated in the Company's treasury so that by December 31, 1962, net working capital has been estimated at about $32 million.

At the same time, during the last four years the Company actively explored promising mining areas in order to develop new mines. Though a number of promising claims are under investigation, no deposit of commercial quantities has yet been discovered. Even if one were discovered in the near future, it would likely take more than three years to develop.

Gunnar has, therefore, turned to a program of diversification outside the mining field where a satisfactory return on capital could be obtained.

However, to invest up to $30 million profitably and with an acceptable degree of risk poses a major problem.

There are few new projects of this size underway in Canada at present in which Gunnar could participate. Further, the possibility of buying a major and profitable company at less than 20 or 25 times earnings is remote. Several months ago, because of his close personal connections with the shareholders of McNamara Corporation Limited, the Gunnar President, Joseph S. LaBine, was able to open negotiations regarding an undertaking whereby Gunnar would acquire McNamara on advantageous terms. The Board of Directors of Gunnar approved the purchase unanimously when an agreement had been reached.

Why McNamara is a sound diversification for Gunnar

Due to its cyclical nature and the difficult times the Canadian construction industry has found itself in the past six years, many informed people question the wisdom of Gunnar to diversify into this field. Although there is some measure of truth in this view, it is believed that for Gunnar the purchase of McNamara is a sound move for the following reasons:

(1) Today, except for public utilities where profits are determined by governments, almost all industries are highly competitive with earnings under severe pressure. Severe competition is, therefore, not unique to the construction industry only.

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[illegible]

Proposal to Purchase McIntyre Porcupine Mines Limited

In order to evaluate properly the proposal to [illegible] Mining Limited as another step in the Corporation's [illegible] it is necessary to [illegible] the present position of Canadian Mining Industry.

McIntyre has had a long and [illegible] history. The Company was incorporated [illegible] in [illegible] a gold property in the Porcupine [illegible] were a [illegible] gold producer. [illegible]

In [illegible] Albert J. [illegible] for Canada a group of [illegible] in the [illegible]. In 1959 the Company [illegible] $10,500,000 through [illegible] and in [illegible] Canada's [illegible]. Since that time [illegible] up to [illegible] $10,500 [illegible] total [illegible] value will have been [illegible]. All [illegible] to sell by 1966. [illegible] from [illegible] at [illegible] $129,779,000.

[illegible] and [illegible] and [illegible] capital has been [illegible].

At the same time, [illegible] the Company [illegible] number of [illegible] likely [illegible].

[illegible]

However, [illegible] degree of [illegible].

There are [illegible] in Canada [illegible] and [illegible] of [illegible] and [illegible].

mcintyre [illegible]

[illegible] the [illegible] in the Canadian [illegible] of [illegible].

(a) Today [illegible] will [illegible] the [illegible].

(2) Construction is one of the most important industries in Canada today, both in terms of value of work performed and workers employed. In the past few years construction has accounted for up to 20% of Gross National Product. Yet despite the size and importance of the industry, there are few public companies engaged in general construction. Most construction work is handled by small and medium sized private companies while large projects, with some notable exceptions, are done by a few large Canadian or subsidiaries of large U.S. or U.K. construction firms.

(3) McNamara Corporation Limited is one of the largest and most successful construction companies in Canada and a leader in its field. The Company has shown an astonishing record of growth since 1953. Its operations are about equally diversified in the areas of marine construction, heavy construction, roads and industrial buildings, and is expanding rapidly in the international markets where profit potentials are higher and competition is less.

(4) There is a great deal of similarity between the operations of a mining company and the operations of a construction company. Gunnar is, therefore, diversifying into an industry which is familiar to it and in which the Company has a great deal of experience. In the U.S. there are some very successful companies who are engaged both in mining and construction.

(5) Because of the long relationships between the two companies and the LaBine and the McNamara families, a merger between the two companies can be effected with a minimal amount of friction between the two managements.

(6) Lastly, the terms of the acquisition are favourable to Gunnar.

Analysis of Purchase

The following table compares the proposed acquisition of McNamara with the recent sale of control of Foundation Company and relates price to book value, earnings, etc.

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Purchase Price Analysis

	McNamara*	Foundation**
Book Value of Equity - 1961	$ 7,921,426	$14,545,479
Net Earnings - 1961	1,193,627	944,485
Average 1957-1961	1,460,000	1,330,000
Depreciation, etc. - 1961	1,803,254	1,157,416
Average 1957-1961	1,927,000	1,590,000
Cash Flow - 1961	2,996,881	2,101,901
Average 1957-1961	3,387,000	2,920,000
Net Return on Equity - 1961	15.1%	6.5%
Cash Flow Return on Equity - 1961	37.8%	14.5%
Fixed Assets, Equipment, etc.		
Total Cost Value - 1962	$33,976,192	$18,395,946 (1961)
Accumulated Depreciation 1962	26,554,879	11,233,486 (1961)
Net Book Value	7,421,313	7,162,460 (1961)
Replacement Value	43,900,000	N.A.
Fair Market Value	23,000,000	N.A.
Book Value of Equity with Equipment at Fair Market Value	23,500,113	N.A.
Effective Purchase Price (100%)	$16,000,000	$17,535,036
Purchase Price/Earnings Ratio - 1961	13.4x	18.6x
Average 1957-1961	11.0x	13.2x
Purchase Price/Cash Flow Ratio - 1961	5.3x	8.3x
Average 1957-1961	4.7x	6.0x

* For purposes of comparison, earnings from disposal of assets have been included in the McNamara earnings. Earnings from this source amounted to $83,219 in 1961 and averaged $66,000 during 1957-1961.

**Foundation's earnings include a transfer from reserves of $400,000. Based on income taxes paid, estimated true earnings in 1961 were about $300,000. This included net gain on disposal of assets of $630,701.

It is noted that in this comparison it should be kept in mind that McNamara is a private company and thus has always taken maximum depreciation allowances provided under the Income Tax Act, and expensed items wherever allowed in order to minimize income tax liabilities.

As a result, McNamara's equipment has a replacement value of almost $44 million, while fair market value exceeds by over $15 million the net depreciated book value of $7,400,000.

It is further noted that the comparison is heavily weighted in favour of Foundation in that in all comparisons the company's stated earnings of $944,485 were used, rather than the estimated true earnings of about $300,000 in 1961.

In addition, it is believed that McNamara's program of repair and maintenance of equipment has been consistently extensive and thorough. For example, in 1962 McNamara expended more than $6,900,000 for this purpose, despite the fact that due to heavy equipment purchases of almost $20 million in the past five

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[illegible] Analysis

	[illegible]	[illegible]	Foundation[illegible]
Book Value of Equity - 1961	[illegible]	[illegible]	[illegible]
Net Earnings - 1961	[illegible]	[illegible]	[illegible]
Average [illegible]	[illegible]	[illegible]	[illegible]
Depreciation, etc. - 1961	[illegible]	[illegible]	[illegible]
Average [illegible]	[illegible]	[illegible]	[illegible]
Cash Flow - 1961	[illegible]	[illegible]	[illegible]
Average [illegible]	[illegible]	[illegible]	[illegible]
Net Return on Equity - 1961	[illegible]	[illegible]	[illegible]
Cash Flow Return on Equity - 1961	[illegible]	[illegible]	[illegible]
Fixed Assets [illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
Book [illegible]	[illegible]	[illegible]	N.A.
Effective [illegible]	[illegible]	[illegible]	[illegible]
Purchase Price [illegible]	[illegible]	[illegible]	[illegible]
Average [illegible]	[illegible]	[illegible]	[illegible]
Purchase [illegible]	[illegible]	[illegible]	[illegible]
Average [illegible]	[illegible]	[illegible]	[illegible]

* [illegible]

** [illegible]

It is noted [illegible]

As a result, [illegible] million, which [illegible]

It is further noted [illegible]

In addition, it is [illegible] $20 million [illegible]

years, much of the equipment is relatively new.

McNamara's net earnings for the fiscal year ending December 31, 1962, are estimated at about $1,000,000 and a cash flow of about $3,800,000. Today McNamara has the largest backlog of orders in its history. Barring unforeseen events, net earnings for 1963 should reach $2 million and cash flow of about $4 million.

Gunnar is, therefore, buying McNamara at 11 times average last five years earnings and at 4.7 times average last five years cash flow.

These averages compare as follows with the price/earnings ratios of companies in related or similar businesses.

Historical Average Annual Share Price/Earnings Ratios

	Average 1957-1961	1961	1960	1959	1958	1957
McNamara	11.0*					
Foundation	11.2 10.2	13.5 15.3	13.8 9.4	10.3 20.8	12.1 7.4	6.39 6.4
Canada Cement	28.0 11.5	26.5 11.3	28.8 13.0	32.0 12.5	27.5 11.4	25.4 9.6
Canada Iron Foundries	26.6 12.4	21.0 8.6	19.5 10.1	28.5 8.4	31.0 10.9	33.1 10.5
Dominion Bridge	21.2 14.7	19.5 25.9	19.0 -	22.1 12.8	22.3 9.0	23.1 7.6
Standard Paving	17.3 (3 yrs.) 21.4	15.3 25.9	16.1 17.5	20.6 16.6	-	-

*Based on average earnings and purchase price.

The table shows that the McNamara price/earnings ratios compare favourably with those prevailing in the industry. Thus from the point of view of net worth (about $23,000,000 versus a tax evaluation of about $9,000,000) or earnings and cash flow, Gunnar is buying McNamara for a reasonable price.

Why did McNamara shareholders sell

Since 1953 McNamara grew rapidly and changed from a medium sized family concern to a large international construction company. The large increases in work undertaken required larger and larger amounts of capital. Though the Company had access to generous bank credit, it reached the stage where it had the following choices:

1. Stop growing.

2. Raise funds by selling common shares and/or long term debt to the public.

3. Associate with a large public company with cash resources.

An amalgamation with Gunnar Mining provided a happy solution. Gunnar is in a related business, the company and its management were well known to McNamara, it had substantial financial resources; in the event Gunnar developed other mines McNamara could do the construction work; and the purchase agreement provided that the McNamara family would continue to have an important share (20%) in the combined company.

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Consolidated Financial Statements

The balance sheets of Gunnar and McNamara have been consolidated as at December 31, 1961, in order to show the strength of the combined companies. In the consolidation it has been assumed that Gunnar would issue 800,000 $1.00 par value shares for $8,000,000 and pay $8,000,000 cash for the purchase of McNamara Corporation.

Pro Forma Consolidated Balance Sheet of Gunnar Mining Limited and McNamara Corporation Limited as at December 31, 1961 (after giving effect to the earlier transactions)

ASSETS

Current		
Cash		$ 233,858
Government securities, short term investments		20,778,643
Other stocks and bonds		2,410,646
Accounts receivable*		13,758,304
Advances to joint ventures		2,020,745
Inventories		4,547,663
Concentrate inventory		4,993,950
Contracts in progress		1,340,296
Prepaid expenses, insurance, etc.		163,437
		$50,247,542
Other Investments		
Unlisted securities	$ 157,745	
Silver bullion	464,719	622,464
Deferred Mine Development Expenses, less write-offs		861,277
Capital Assets, at cost		
Mining claims, properties, etc.	$ 1,444,991	
Mining plant, equipment	22,424,103	
	$23,869,094	
Less: Depreciation	19,744,393	4,124,701
Construction equipment	$19,497,557	
Marine equipment	5,975,484	
Other	4,143,151	
	$29,616,192	
Less: Depreciation	24,554,879	5,061,313
Land		212,189
Cost of acquisition of shares of McNamara in excess of book value		8,078,574
TOTAL ASSETS		$69,208,060

*Mainly holdbacks and progress payments due from government agencies.

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LIABILITIES

Current		
Bank Loans (unsecured)		$14,318,935
Accounts payable		5,818,628
Taxes payable		1,426,598
Current portion advance payments		2,225,000
		$23,789,161
Advance Payments		
Deferred concentrate deliveries	$5,877,140	
Less current portion	2,225,000	3,652,140
Minority Interest		134,030

Shareholders' Investment

Capital Stock	
Authorized: 5,000,000 shares of $1.00 each par value	
Issued and fully paid: 4,341,649 shares	4,341,649
Add: premium on shares, net	8,113,031
	$12,454,680
Surplus	29,178,049
TOTAL LIABILITIES	$69,208,060

Since December 31, 1961, both companies have progressed. Gunnar estimates that it will earn in 1962 about $4,800,000 while write-offs will amount to about $2,400,000. Thus cash flow will amount to $7,200,000 out of which $3,541,649 has been paid in dividends.

McNamara is expected to earn about $1,000,000 in 1962 and have a cash flow of about $3,800,000. McNamara purchased $4,360,000 worth of equipment during the year and redeemed 14,322 preference shares of $10 each at par.

Summarizing the earnings of both companies and forecasting them for the next few years, the following will result:

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McNamara Corporation Limited
(In Thousands of Dollars)

	1960	1961	1962	Estimated 1963	Estimated 1964
Operating Profit	5,505	3,943	4,800	6,000	6,800
Depreciation	1,714	1,803	2,800	2,000	2,200
Profit	3,791	2,140	2,000	4,000	4,600
Income Tax	2,199	1,030	1,000	2,000	2,300
Net Profit	1,592	1,110	1,000	2,000	2,300

Gunnar Mining Limited

	1960	1961	1962	Estimated 1963	Estimated 1964
Operating Profit	8,352	9,013	8,500	9,100	3,200
Amortization	2,747	2,826	2,400	2,200	-
Net Operating Profit	5,605	6,187	6,100	6,900	3,200
Investment Income	1,021	1,216	1,500	1,000	1,200
Total Profit	6,626	7,403	7,600	7,900	4,400
Income Tax	1,448	1,595	2,800	2,900	1,700
Net Profit	5,178	5,808	4,800	5,000	2,700
Net Profit per Existing Share	\$1.46	\$1.64	\$1.36	\$1.41	\$0.76

Gunnar and McNamara Combined

	1960	1961	1962	1963	1964
Cash Flow	11,232	11,547	11,000	11,200	7,200
Net Profit after Tax	6,770	6,918	5,800	7,000	5,000
Shares to be outstanding		4,341,649			
Cash Flow per Share	\$2.59	\$2.66	\$2.53	\$2.58	\$1.66
Net Profit per Share	1.56	1.59	1.34	1.61	1.15

Making earnings forecasts for companies such as Gunnar and McNamara is of course hazardous. Nevertheless, we believe the above forecast will likely err on the conservative side. It was assumed that Gunnar would not be able to obtain any further uranium contracts and that its funds would remain invested in government securities. The latter is probably unlikely, since the Company can be expected to find other investments more profitable than the return from government securities.

McNamara is rapidly expanding its foreign operations, which are often more profitable than similar operations in Canada. With the financial strength of Gunnar Mining, McNamara will be able to bid on or participate in larger projects. Normally competition is keen on small and medium sized contracts and profit margins are generally slim. As the contract is larger, fewer construction firms have the resources or capabilities to undertake such jobs. As a result competition is limited and profit margins higher.

We have estimated McNamara's earnings for 1963 at $2,000,000. This forecast is probably low, considering that the Company has its largest volume of work on hand in its history. Earnings could therefore be higher. By 1964 the foreign operations should be well established and after five difficult years the Canadian construction industry should be more active by that time.

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This forecast shows, therefore, the importance to Gunnar of replacing the earnings power from uranium sales with other sources if it is to maintain a generous dividend policy.

Conclusion

The past performance of the Gunnar management has been impressive. However, whether Gunnar will obtain further uranium contracts cannot now be determined. The search for new mines will continue with even more vigor. Gunnar is spending and will continue to spend about $800, 000 annually on mining and oil exploration. The large cash reserves are more than adequate to provide sufficient funds to develop new mines or to diversify in other fields.

It is our belief that the blending of the Gunnar-McNamara organizations should ensure rapid growth in the next few years. A large measure of this confidence is based on our high opinion of the McNamara management team. This group of about 40 young professional people, with an average age of 39, is keen and aggressive with the capabilities to accelerate the Company's remarkable rate of growth.

M. Gaasenbeek.

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